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Bankruptcy Judge
United States Courthouse
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UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF WASHINGTON
AT SEATTLE

This matter came before the Court on October 21, 2009, on Deutsche Bank's Objection to Confirmation of Chapter 13 Plan, filed on October 14, 2009, on behalf of Deutsche Bank National Trust Company ("Creditor"). The Court heard oral argument on October 21, 2009, and invited the parties to file additional submissions on the question of whether the debtor, Aida Reyes ("Debtor"), was entitled to modify Creditor's secured claim under Bankruptcy Code § 1322(b)(2).¹ The hearing was continued to December 2, 2009.

On November 9, 2009, Debtor filed a Memorandum of Points and Authorities and a declaration in support. Creditor filed a Supplemental Memorandum in Support of the Objection to

¹ Unless otherwise indicated, all Chapter and Section references are to the Bankruptcy Code, 11 U.S.C. §§ 101 et seq. As amended by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA").

MEMORANDUM DECISION - 1

1 Confirmation by Deutsche Bank, "as Trustee for Morgan Stanley ABS
2 Capital I Inc. Trust 2006-WMC2 Through Its Servicing Agent
3 America's Servicing Company" on November 25, 2009, as well as a
4 declaration in support. Finally, on November 30, 2009, Debtor
5 filed Debtor's Reply to Deutsche Bank's Supplemental Memorandum.
6 The hearing scheduled for December 2, 2009 was stricken by the
7 Court and the matter was taken under advisement.

8 **I. Facts.**

9 The following facts are undisputed.² On or about March 3,
10 2006, Debtor executed and delivered a note in favor of WMC
11 Mortgage Corp in the original principal amount of \$456,300.00
12 (the "Note"). The Note was secured by a Deed of Trust (the "Deed
13 of Trust") encumbering real property commonly described as 7502
14 30th Ave. N.E., Seattle, WA 98115 (the "Property"). Debtor filed
15 this chapter 13 proceeding on July 29, 2009. Debtor is a single
16 woman who lives in a five bedroom home located at the Property.

17 In 1993, Debtor began taking in boarders to live with her at
18 the Property and she has continued to rent rooms to boarders
19 since then. Most of Debtor's boarders are foreign exchange
20 students who are referred to her by organizations such as the
21 American Cultural Exchange and USA International and Abode.
22 Other boarders come to Debtor through other referral services.
23 Debtor receives initial rent payments directly from the referring
24 organizations and executes a written rental agreement with each
25

26 ² See Docket no. 31. Aida Reyes' Declaration (Main
27 Document), Letter from A.C.E. Language Institute (Exhibit 1), and
Uniform Underwriting and Transmittal Summary (Exhibit 2).

1 boarder. The students make subsequent rent payments directly to
2 Debtor on a monthly basis.

3 The boarders who live at the Property share a common kitchen
4 and receive food and meals from Debtor as part of their rental
5 agreement. Each boarder is entitled to a furnished room and
6 generally three hot dinners per week. Debtor shops for the
7 tenants' food and makes it available in the common kitchen. She
8 also maintains the common areas in a clean and usable fashion and
9 otherwise helps the boarders become acclimated to the
10 neighborhood and Seattle.

11 Debtor currently receives approximately \$2,100.00 per month
12 in rental payments, depending on the number of boarders and their
13 relative rental agreements. The total amount of rent she
14 receives has not substantially increased since 2006, when the
15 Note and Deed of Trust were executed.

16 Prior to early 2009, Debtor earned \$41,500.00 annual gross
17 income, or \$3,450 monthly gross income, from her full-time work
18 at the University of Washington as a laboratory technician. She
19 worked at the University of Washington for nearly 25 years before
20 she was forced to retire due to a disability in early 2009.

21 The loan application prepared in connection with the Note
22 and Deed of Trust reported total "base income" of \$5,564 per
23 month. Although the amount did not break out separately wages
24 and rental income, it is undisputed that the reported amount
25 includes both Debtor's then current income from the University of
26 Washington and her monthly rental income from boarders. Debtor
27 testified in her declaration that when she applied for the loan,
28

MEMORANDUM DECISION - 3

1 she informed the person who represented the lender of her dual
2 sources of income. She was asked to provide proof of income from
3 both sources, including a W-2 form for proof of her wages from
4 the University of Washington and a copy of her bank statements
5 showing steady deposits for proof of her rental income. Debtor
6 provided the necessary documentation, including the documents
7 required to prove her rental income. She also offered a letter
8 from a placement agency in support of her loan application.

9 The Note evidences a loan in the amount of \$456,300 with an
10 adjustable rate of interest ranging from 7 to 14%. Debtor's
11 wages from the University of Washington, without more, would
12 barely have covered the loan payments at the lowest rate.

13 **II. Law.**

14 A. The loan is not protected by the Anti-Modification
15 Provision of 11 U.S.C. §1322(b)(2).

16 Debtor has argued that her Property does not fall within
17 the scope of the Section 1322(b)(2) anti-modification provision
18 because her Property is not merely her personal residence, but
19 contains an income-producing rooming house business that was
20 present at the time the loan was made. The Bankruptcy Code
21 allows modification of secured loans; however, a Bankruptcy
22 Court's power to modify loans does not extend to loans secured
23 "only by a security interest in real property that is the
24 debtor's personal residence." § 1322(b)(2). The issue,
25 therefore, is whether Creditor's lien is secured only by the
26 Debtor's "personal residence."

27 Bankruptcy Courts have been inconsistent in their

28 MEMORANDUM DECISION - 4

1 interpretation of what is a "residence" when the debtor rents out
2 some portion of the home to third parties. The Ninth Circuit has
3 not ruled on the issue. The Debtor relies on *In re Scarborough*,
4 461 F.3d 406 (3rd Cir. 2006), in which the court held that "based
5 on the plain language of 1322(b), a creditor does not receive
6 anti-modification protection for a claim secured by real property
7 that includes both the debtor's principal residence and other
8 rental property that is not the debtor's principal residence."
9 *Id.* at 411. Conversely, another court held "that the residence
10 in which the debtor primarily resides is also a source of income
11 to the debtor does not render it 'something other than a primary
12 residence.'" *In re Guilbert*, 176 B.R. 302, 305 (D.R.I. 1995).

13 Other courts have allowed modification of a loan secured by
14 an interest in property in which debtor resides when the property
15 involves multi-unit dwellings. See *In re Maddaloni*, 225 B.R. 277
16 (D. Conn 1998); *Lomas Mortgage, Inc. v. Louis*, 82 F.3d 1 (1st
17 Cir. 1996); *In re Bulson*, 327 B.R. 830 (Bankr. W.D. Mich. 2005).
18 Yet, another line of cases adopts a case-by-case approach and
19 employs a flexible, multi-factor test to determine whether the
20 parties intended the loan to be residential or commercial in
21 nature at the time it was made. Loans that are residential in
22 nature may be modified, whereas loans that are commercial in
23 nature may not. See *Litton Loan Servicing, LP v. Beaman*, 298 B.R.
24 508, 511-12 (N.D.N.Y. 2003); *In re Brunson*, 201 B.R. 351, 353
25 (Bankr. W.D.N.Y. 1996).

26 In a number of the cases referenced above, courts have
27 expressed the concern that "on the eve of the commencement of his
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1 Chapter 13 proceeding a debtor could sidestep the mortgage
2 exception by adding a second living unit to the property." *In re*
3 *Bulson*, 327 B.R. 830, 846 (Bankr. W.D.Mich. 2005); *see also In re*
4 *Guilbert*, 176 B.R. 302, 305 (D.R.I. 1995). In this case, Debtor
5 has been operating a boarding house for approximately 16 years,
6 so the concern of these courts is not present.

7 Courts have held that for the purposes of Section
8 1322(b)(2), the character of the property should be determined as
9 of the time the creditor takes a security interest in the
10 collateral because it is at that point that the lender must
11 consider whether the loan may be subject to modification at some
12 future time. *In re Scarborough*, 461 F.3d at 412; *see also*
13 *Bulson*, 327 B.R. at 846. Thus, a crucial fact is whether the
14 Creditor in this case knew of Debtor's boarding business at the
15 time the loan was made.

16 The facts of this case fall somewhere between *Scarborough*,
17 which involved two separate living units, one rented and one used
18 solely by the debtor, and *Guilbert*, in which the debtor rented a
19 portion of her residence to family members. In this case, Debtor
20 had a well-established boarding business before she borrowed
21 money from Creditor. Of the five bedrooms in the Property,
22 Debtor occupies only one. She provides cleaning and meal service
23 for four boarders and the income she derives from those services
24 is significant. The Deed of Trust states at paragraph 6 that
25 Debtor "shall occupy, establish, and use the Property as
26 borrower's principal residence...." Debtor does use the Property
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28 MEMORANDUM DECISION - 6

1 as her principal residence, but she also uses the Property to
2 operate a boarding house.³ Although the Property does not
3 contain separate living units like the property in *Scarborough*,
4 Debtor is conducting an actual boarding business, unlike the
5 debtor in the *Guilbert* case.

6 Debtor's testimony that she advised the loan officer of her
7 rental income at the time she applied for the loan and was asked
8 to provide proof of such income is uncontested. Debtor provided
9 the lender with bank statements to show consistent rental income
10 from her boarding business. Thus, the Creditor knew of Debtor's
11 rental income and boarding business when the Creditor took a
12 security interest in the Property and should have known that the
13 loan could be subject to modification in a Chapter 13 proceeding.
14 It is clear that without the additional income, Debtor would not
15 have been able to make the payments under the Note and would not
16 have qualified for the loan.

17 *Scarborough* and its followers rely on a plain language
18 reading of the statute. These courts hold that by using the word
19 "is" in the phrase "real property that is the debtor's principal
20 residence," Congress equated the terms "real property" and
21 "principal residence." *In re Scarborough* 461 F.3d 406, 413.
22 Therefore, the courts have reasoned that the use of "is" "means
23

24
25 ³ Creditor contends that Debtor's boarding business violates
26 local ordinances and the Deed of Trust, which requires that she
27 operate the Property in accordance with all laws. The Court
makes no finding as to whether Debtor's business violates some
local ordinance and a determination of that issue is not
necessary to the Court's ruling.

1 that the real property that secures the mortgage must be *only* the
2 debtor's principal residence in order for the anti-modification
3 provision to apply." *Id.* The Court agrees with the reasoning in
4 *Scarborough*. Any other construction of Section 1322(b)(2) would
5 read the word "only" out of the statute. Accordingly, the Court
6 finds that Creditor's lien is not protected by the anti-
7 modification provision of Section 1322(b)(2).

8 B. Standing.

9 Debtor challenges Creditor's standing in this case. She
10 cites Judge Brandt's opinion in *In re Peter A. Jacobson et al.*,
11 402 B.R. 359 (Bankr. W.D. Wash. 2009), in which Judge Brandt
12 addressed a claim by a servicer as follows: "[t]he real party in
13 interest in relief from stay is whoever is entitled to enforce
14 the obligation sought to be enforced. Even if a servicer or
15 agent has authority to bring the motion on behalf of the holder,
16 it is the holder, rather than the servicer, which must be the
17 moving party, and so identified in the papers and in the
18 electronic docketing done by the moving party's counsel."
19 (*Jacobson* at page 10 of 18).

20 In the Affidavit of Teressa Williams (Docket No. 33), filed
21 by Creditor in support of its objection to confirmation,
22 Ms. Williams declares under oath that America's Servicing Company
23 is servicing the loan for Deutsche. She further declares that
24 the Note is endorsed in blank and that America's Servicing
25 Company is "in possession of the original endorsed promissory
26 Note." Williams Decl., ¶ 3. The Deed of Trust has been assigned
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1 to Deutsche, but Debtor points out that the assignment was signed
2 by a representative of Mortgage Electronic Registration Systems,
3 Inc. and not by any officer or representative of the previous
4 Deed of Trust holder, WMC. Williams Decl., Ex. C. The moving
5 party here is Deutsche, although the Note is in the possession of
6 America's Servicing Company, the servicer. There is no evidence
7 that America's Servicing Company is holding the note for the
8 benefit of Creditor, nor is it clear whether the assignment of
9 the Deed of Trust is valid. In the absence of evidence that
10 America's Servicing Company has authority to hold the Note for
11 the account of Creditor and of a valid chain of assignments from
12 the original holder of the Deed of Trust to Creditor, the Court
13 is unable to find that Creditor has standing.

14 **CONCLUSION**

15 For the foregoing reasons, the Court will deny the objection
16 to confirmation filed by Creditor upon Debtor's presentation of
17 an order consistent with this decision.

18 ///END OF MEMORANDUM DECISION///

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20 
21 United States Bankruptcy Judge
22 (Dated as of Entered on Docket date above)

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28 MEMORANDUM DECISION - 9